

# Practice Examination Solution

## Chapter 9 (Other Income And Deductions)

### Examination Summary

The marks you have received on each question can be added in the final column.

Question	Type Of Question Or Subject	Total Marks	Your Mark
1	Essay Question	10	
2 - 7	True Or False Questions	9	
8 - 14	Multiple Choice Questions	21	
15	Moving Costs	25	
16	Income Attribution	35	
Total		100	

### Solution 1 (10 Marks)

First, she must **elect out** of the **spousal rollover** [(ITA 73(1)]. This will be accomplished by **including the gain** on the shares in her **income tax return**.

In addition, the spouse must **provide consideration** for the shares that is equal to their **fair market value**. The consideration must either be provided out of the spouse's **own funds** or by a **debt obligation** that pays interest at the **prescribed rate** or higher.

If income attribution applies, the consequences would be that any **income earned** by the property while it is **in the hands of the spouse** would be **attributed back** to the individual.

In addition, if the spouse disposes of the property, any **gain on the sale** would be **attributed back** to the individual.

**1 grading point for each highlighted item. Total 14**

**Your Mark = [(# of grading points ÷ 14)(10%)] = \_\_\_\_%**

### Solutions 2 Through 7 (9 Marks)

- True.** Workers' Compensation payments are included in Net Income For Tax Purposes, but deducted in the determination of Taxable Income.
- False.** They can also be deducted against business income, and scholarships.
- True.** Child care costs can be deducted by the higher income spouse when the lower income spouse is confined to prison for not less than two weeks in the year.

5. **False.** The disability does not have to be severe and prolonged.
6. **True.** Spousal support is deductible to the payor and taxable to the recipient.
7. **False.** While dividend income is attributed back to the individual, capital gains would not be.

**1 grading point for each correct answer. Total 6**

**Your Mark = [(# of grading points ÷ 6)(9%)] = \_\_\_\_%**

### **Solutions 8 Through 14 (21 Marks)**

8. **B.** The universal child benefit payments must be included in the income of the lower income spouse.
9. **B.** The limit depends on the age of the child and can be \$4,000, \$7,000, or \$10,000.
10. **B.** The amount of \$1,300 would be the \$5,500 [(10)(\$550)] paid, less the required child support payments for the year of \$4,200 [(12)(\$350)].
11. **A.** Earnings on assets that are held in the plan accumulate on a tax free basis.
12. **D.** Contributions to the plan are supplemented by Canada Education Savings Grants.
13. **B.** The income attribution rules do not apply to earnings on assets held in the plan.
14. **D.** \$6,656 [(138%)(\$1,200) + (1/2)(\$30,000 - \$20,000)]

**1 grading point for each correct answer. Total 7**

**Your Mark = [(# of grading points ÷ 7)(21%)] = \_\_\_\_%**

### **Solution 15 (25 Marks)**

The allowable moving expenses can be calculated as follows:

Expenses Of First Trip After Acquiring New Residence		
Hotel (3 Days At \$90)	\$270	
Food (3 Days At \$30)	90	\$ 360
Selling Costs Of Old Residence (\$9,000 + \$1,500)		10,500
Acquisition Cost Of New Residence (\$1,750 + \$1,100)		2,850
Expenses Of Travel To Ottawa		
Gas	\$ 415	
Hotel (16 Days At \$75)	1,200	
Food (16 Days AT \$60)	960	2,575
Moving Company Fees		4,500
Total Allowable Expenses		\$20,785
Employment Income In New Location		( 8,000)
Carry Forward		\$12,785

**Notes:**

1. With respect to the first trip, only the food and lodging costs that occurred after the acquisition of the new residence would be allowed. Neither the airfare nor the car rental costs are deductible by Mr. Tully.
2. The property taxes on the old home to the date of sale would **not be deductible**.
3. The limit of 15 days expenses for meals and lodging near the old or new homes would not be exceeded in this situation. More explicitly, there were 3 days on the first trip and only 10 days after arriving in Ottawa. The remaining 6 days are travel costs and do not count toward the 15 day limit.
4. The storage costs are deductible.
5. The fact that Mr. Tully started work for the new employer fairly late in the current year acts to limit the amount that he can deduct. However, the unused balance of \$12,785 can be carried forward.

**1 grading point for each highlighted item. Total 16**

**Your Mark = [(# of grading points ÷ 16)(25%)] = \_\_\_\_%**

**Solution 16 (35 Marks)****Mrs. Morris At Transfer**

With respect to the shares given to Martha, Mrs. Morris will be required to recognize a gain at the time of transfer as follows:

Fair Market Value At Transfer Date [(5,000)(\$20)]	\$100,000
Adjusted Cost Base [(5,000)(\$15)]	( 75,000)
Capital Gain	\$ 25,000
Inclusion Rate	<b>1/2</b>
<b>Taxable Capital Gain</b> For Mrs. Morris	\$ 12,500

Since Mrs. Morris **did not elect out of Section 73** on the transfer to Mr. Morris, the shares are transferred at her adjusted cost base and **no gain** will be recognized when the shares are transferred.

**Mrs. Morris - Dividends**

There will be attribution of the dividend income, both on the shares given to her **husband** and to her **daughter** Martha. The taxable amount will be \$13,800 [(10,000)(\$1.00)(138%)].

**Mrs. Morris - Sale By Husband And Daughter**

As Mrs. Morris did not elect out of the ITA 73(1) rollover, the income attribution rules will apply on the sale of shares by Mr. Morris. The attributed income will be calculated as follows:

Proceeds To Mr. Morris [(5,000)(\$22)]	\$110,000
Adjusted Cost Base [(5,000)(\$15)]	( 75,000)
Capital Gain	\$ 35,000
Inclusion Rate	<b>1/2</b>
<b>Taxable Capital Gain</b> Attributed To Mrs. Morris	\$ 17,500

As there is **no attribution of capital gains** on shares transferred to a **related minor**, the sale of Martha's shares will have **no effect** on Mrs. Morris.

**Mr. Morris At Transfer**

As Mrs. Morris did not elect out of the rollover, the gift will have **no effect** on the income of Mr. Morris. The adjusted cost base to Mr. Morris will be \$75,000  $[(1/2)(\$150,000)]$ .

**Mr. Morris - Dividends**

As Mrs. Morris did not elect out of the rollover, the **dividends will be attributed** back to her. They will **not be included** in the income of Mr. Morris.

**Mr. Morris At Sale**

As Mrs. Morris did not elect out of the rollover, the **capital gains will be attributed** back to her. They will **not be included** in the income of Mr. Morris.

**Martha Morris At Transfer**

The gift of shares from her mother will have **no immediate effect** on her income. However, her adjusted cost base for the shares will be the fair market value of \$100,000  $[(\$5,000)(\$20)]$ .

**Martha Morris - Dividends**

As all of the dividends are **attributed back to her mother**, they will **not be included** in Martha's income.

**Martha At Sale**

The capital gain that accrued subsequent to the transfer of the shares will be allocated to Martha. The amount is calculated as follows:

Proceeds Of Disposition $[(\$5,000)(\$26)]$	\$130,000
Adjusted Cost Base $[(\$5,000)(\$20)]$	( 100,000)
Capital Gain	\$ 30,000
Inclusion Rate	<b>1/2</b>
<b>Taxable Capital Gain</b> For Martha	\$ 15,000

**1 grading point for each highlighted item. Total 40**

**Your Mark =  $[(\# \text{ of grading points} \div 40)(35\%)] = \_\_\_\%$**